Supreme Court of the United

No. 13, October Term, 19

THE TRAINOR COMPANY,

vs.

THE AETNA CASUALTY AND SURETY COMPANY,

On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

BRIEF FOR APPELLEE.

Counsel for Appellee.

INDEX.

	Page
Official Report of the Opinions Below	1
Statement of the Case	1
The Questions of Law Involved	8
Argument	9
I. There Is No Substantial Difference Between the Measure of Damages Recoverable by a Mortgagee-Obligee for the Breach of a Bond Giving an Absolute Guarantee of Completion and for the Breach of a Bond Indemnifying Against Loss for Failure to Complete	9
II. The Measure of Damages Due to a Mortgagee-Obligee for the Breach of a Bond Guaranteeing Completion of a Building Operation Is Limited to the Difference Between the Value of the Property in the Condition in Which It Existed at Default and the Amount of Principal and Interest Due on the Mortgage and All Prior Liens	13
III. The Trial Court and the Circuit Court of Appeals in Affirming the District Court Were Both Entitled to Exercise Their Independent Judgment Regarding the Proper Measure of Damages to Be Awarded the Petitioner	20
1. Federal Courts Exercise an Independent Judgment, Irrespective of the Decisions of the Local State Courts in Matters of General Jurisprudence and Commercial Law	20
2. The Question of Measure of Damages for Breach of a Completion Bond Whether Considered to Be a Matter of Suretyship or of Damages Is Primarily a Matter of General Jurisprudence Concerning Which the Federal Courts May Exercise Their Independent Judgment	27
(a) Questions of Suretyship Are Matters of General Jurisprudence	27

Page

(b) The Questions Relating to the Measure of Damages Are Matters of General Jurisprudence 32

(c) The Use of Completion Bonds Throughout the Nation Requires a National Uniform Law and, Therefore, Questions Pertaining Thereto Are Matters of General Jurisprudence 34

Conclusion 40

TABLE OF CASES CITED.

Aetna Insurance Co. v. Commonwealth, 106 Ky. 864, 876 24

Aetna Life Ins. Co. v. Roewe, 38 F. (2d) 393 (C. C. A. 7th 1930) 26, 29

Baltimore & Ohio Railroad Company v. Baugh, 149 U. S. 368. 371 (1892) 23, 25

Bancroft v. Hambly, 94 Fed. 975 (C. C. A. 9th 1899) ... 30

Belloni v. Freeborn, 63 N. Y. 383 12

Black and White Taxicab and Transfer Company v. Brown and Yellow Taxicab and Transfer Company, 276 U. S. 518 (1928) 23

Board of Education v. Maryland Casualty Co., 27 Fed. (2d) 20 (C. C. A. 3d) 19

Burgess v. Seligman, 107 U. S. 20 (1882) 37

Butz v. City of Muscatine, 8 Wall. 575, 582 (1869) 22

Bu-Vi-Bar Petroleum Corporation v. Krow, 40 Fed. (2d) 488 (C. C. A. 10th) 26, 33

Carpenter v. Providence Washington Ins. Co., 16 Pet. 495 (1842) 28

Clark v. Belt, 223 Fed. 573 (C. C. A. 8th) 33

Cole v. Pennsylvania Railroad Co., 43 F. (2d) 953 (C. C. A. 2d 1930) 26, 27

Community Bldg. Co. v. Maryland Casualty Co., 8 Fed. (2d) 678 (C. C. A. 9th) 26

TABLE OF CASES CITED—Continued.

Page

Concordia Insurance Co. of Milwaukee v. School District No. 98 of Payne County, Oklahoma, 282 U. S. 545 (1931) 38

Dernberger v. Baltimore & Ohio Railway Company, 243 Fed. 21, 40 (C. C. A. 4th 1917) 40

Equitable Trust Co. v. National Surety Co., 214 Pa. 159, 63 Atl. 699 19

Farmers' Bank v. Hayes, 58 F. (2d) 34 (C. C. A. 6th 1932) 26, 30

German-American Title & Trust Co. v. Citizens' Trust & Surety Co., 190 Pa. 247, 42 Atl. 682 15

Hart v. Adair, 244 Fed. 897 (C. C. A. 9th, 1917) 39

Hay v. Cudaback, 139 Fed. 369 (C. C. A. 3d) 11

Henry W. Putnam Memorial Hospital v. Allen, 34 F. (2d) 927 (C. C. A. 2d 1929) 39

Home Ins. Co. v. Currie, 54 F. (2d) 203 (C. C. A. 5th 1931) 26

Hunt v. Warnick's Heirs, 3 Hardin 61 24

John Deere Plow Co. v. Mowry, 222 Fed. 1 (C. C. A. 6th 1915) 39

Johnson v. Charles D. Norton Co., 159 Fed. 361 (C. C. A 6th 1908) 30

Kansas City Hydraulic Press Brick Co. v. National Surety Co., 149 Fed. 507 (C. C. Mo.) 27

I Kent's Commentaries (14th ed.) pp. 451, 602 24

Kidd v. McCormick, 83 N. Y. 391 12

Kibby v. New England Mutual Life Ins. Co., 59 F. (2d) 9 (C. C. A. 3d 1931) 30

Kuhn v. Fairmont Coal Co., 215 U. S. 349 (1910) 37

Lake Shore & Michigan Southern Railway Co. v. Prentice, 147 U. S. 101 (1893) 32

Lathrop v. Commercial Bank, 8 Dana 114, 121 24

Long v. Monarch Accident Ins. Co., 30 F. (2d) 929 (C. C. A. 4th 1929) 26, 29

Longfellow v. McGregor, 61 Minn. 494, 63 N. W. 1032 .. 15

Mechanics Trust Co. v. Fidelity & Casualty Co., 304 Pa. 526, 156 Atl. 146 ..... 18, 19, 35

Page

Meigs v. London Assurance Co., 126 Fed. 781 (C. C. Pa.), 134 Fed. 1021 (C. C. A. 3d) 28
Mitsubishi Shoji Kaisha, Ltd., v. Davis, 291 Fed. 882 (D. C. N. Y.) 34
Nider v. Commonwealth, 140 Ky. 684, 686..... 24
Norfolk & P. Traction Co. v. Miller, 174 Fed. 607 (C. C. A. 4th 1909) 33
Norway Plains Savings Bank v. Moors, 134 Mass. 129. 14
Odegard v. General Casualty & Surety Co., 44 Fed. (2d) 31 (C. C. A. 8th) 26, 27
Province Securities Corporation v. Maryland Casualty Co., 269 Mass. 75 168 N. E. 252 .....11, 13
Purdy v. Massey, 306 Pa. 288, 297, 159 Atl. 545, 548 .....9, 11, 15, 19, 31, 35
Ray v. Sweeney, 14 Bush, 1, 9, et seq..... 24
Schwartz & Co. v. Aimwell Co., 227 N. Y. 184, 124 N. E. 892 12
Sears v. Greater New York Development Co., 51 F. (2d) 46 (C. C. A. 1st 1931).....26, 30
Security Life Ins. Co. v. Brimmer, 36 F. (2d) 176 (C. C. A. 8th 1929); Certiorari Denied 281 U. S. 744 (1930) 29
Spinks v. Mutual Reserve Fund Life Ass'n, 137 Fed. 167 (C. C. E. D. Ky. 1905) 29
Swift v. Tyson, 41 U. S. 1 .....20, 25, 26
Trainor Co. v. Aetna Casualty & Surety Co., 62 F. (2d) 487, 489 (C. C. A. 3d 1932) 26, 32
Union Indemnity Co. v. Vettor, 40 Fed. (2d) 606 (C. C. A. 5th) 10
Washburn & Moen Mfg. Co. v. Reliance Ins. Co., 179 U. S. 1 29
Weightman v. Union Trust Co., 208 Pa. 449, 57 Atl. 879 11
Wicker v. Hoppock, 73 U. S. 94 .....11, 19
Woldson v. Larson, 164 Fed. 548 (C. C. A. 9th, 1908)... 33

IN THE

Supreme Court of the United States.

No. 13. October Term, 1933.

THE TRAINOR COMPANY,
Appellant,

v.

THE AETNA CASUALTY AND SURETY COMPANY,
Appellee.

OFFICIAL REPORT OF THE OPINIONS BELOW.

The opinion of the District Court for the Eastern District of Pennsylvania (R. 31) is reported in 49 F. (2d) 769.

The opinion of the Circuit Court of Appeals (R. 63) is reported in 62 F. (2d) 487.

STATEMENT OF THE CASE.

The Appellee presents the following detailed abstract of the case:

The appellant's action was in assumpsit, to recover damages on a surety bond of the appellee guaranteeing the completion of a building operation, comprising fifty-two houses, known as Copley Homes, Inc., located at Copley Road and Walnut Street, Upper Darby Township, Delaware County, Pennsylvania.

The Sun Mortgage Company was a company engaged in financing building operations through first and second mortgage moneys (R. 31).

The appellant conveyed certain real estate to Copley Homes, Inc., to carry out the building operation and, in order to finance it, borrowed the money from the Sun Mortgage Company and its subsidiary, Realty Bond and Mortgage Company (R. 31).

Settlement was had, and the price of the land without the houses to the Trainor Company was $76,000 and to the Copley Homes, Inc., $104,000 (R. 34). Copley Homes, Inc., paid The Trainor Company the $28,000 due it by giving to The Trainor Company its note for that amount and assigning to it as collateral the equity in the second mortgage (R. 32).

The appellant was not bound to disclose to the appellee the fact that the $28,000 of purchase price owing to it by Copley Homes, Inc., represented profit made by it without capital investment and arising from merely increasing the price of land which it was in a position to acquire at a lower figure (R. 36).

The appellant has received $13,026.02 from Copley Homes, Inc., on account of its obligation to pay the said $28,000 (R. 35).

The appellee at the time of settlement wrote its bond, dated October 13, 1927, in the sum of $220,000, conditioned upon the completion of the houses, which bond was in favor of the Land Title & Trust Company and the Realty Bond and Mortgage Company and The Trainor Company, upon the basis of the Copley Homes, Inc., obtaining a loan of $238,000 from the Land Title & Trust Company, $63,000 from the Realty Bond and Mortgage Company, and that The Trainor Company accepted from Copley Homes, Inc., a note in the amount of $28,000, being the balance of the purchase price due The Trainor Company for the real estate (R. 9):

The bond provided:

> "That if within ten months of the date hereof each of the lots or premises described in each of the said 52 first mortgages shall be fully improved and completed with a building together with other improvements (such as paved streets, sidewalks, driveways, gas, water, sewerage, etc.), in keeping with and as shown by the aforesaid plans, specifications and conditions, building plots and surveys . . . . then in the event that all of the above and below mentioned conditions are fully performed, this bond shall be void; otherwise it shall remain in full force and effect in law."

It further provided that in the event that the building operation in accordance with the Plans and Specifications was not completed within ten months from October 13, 1927, then the bond would be in full force and effect. The bond set forth other rights and remedies.

The building operation progressed, but at the end of the ten-month period, namely, August 13, 1928, it was not fully completed. Approximately twenty-eight houses remained at that time in an incompleted state (R. 33). They were not very far from completion, the work actually remaining to be done consisted of the installation of plumbing accessories, spigots, shower curtains, rods; painting (which was about 75 per cent. complete), papering, and installation of gas ranges and minor details in connection with carpenter work, plastering and brick work (R. 33).

There was a first mortgage of $4500 against each of the fifty-two lots, a blanket second mortgage of $88,000 covering the entire tract, which mortgage had a release clause of $2000 per house, so that the net result of the financing was in substance that each of the lots had against it a first mort-

gage of $4500 and what amounted to a second mortgage of $2000, that there was a small equity in the first mortgage (which may be disregarded) and an equity in the second mortgage over and above the amount borrowed upon it amounting to approximately $636 per lot. The equity in the second mortgage was assigned to The Trainor Company as collateral security for its note of $28,000 (R. 32).

The building operation was ultimately completed on December 27, 1929, by the Sun Mortgage Company, holder of the first mortgage as a result of a settlement made by the Sun Mortgage Company with the Aetna Casualty and Surety Company (R. 33).

The value of the twenty-eight uncompleted houses as of August 13, 1928 was $6700 each (R. 33). This amount is in excess of the appellant's mortgage on each house and on all prior liens.

In January, 1930, the Sun Mortgage Company foreclosed the first mortgages, bought in the properties and wiped out the second blanket mortgage and the equity of The Trainor Company therein (R. 35).

The Trainor Company, although it had very drastic rights under its bond with the defendant, never took advantage of any of them or made any claim on them until suit was brought. Those rights are as follows:

> "(a) On ten days written notice to the herein Surety, any one or more of the said Obligees may replace any Contractor who may fail to diligently proceed (for any reason) to perform the work and/or supply the material covered by his or their Contract for any part of the building or improvements covered by the aforesaid Plans and Specifications and Conditions, and may in place and stead of such replaced Contractor, employ any other party or parties to do,

supply and complete the work and/or material called for under the terms of any such Contract. However, said Surety shall have the right within said ten days to arrange for the prompt supply and completion of such work and material, with a party or parties satisfactory as to competence to said Trust Company or its Successors.

"(b) On fifteen days written notice to the herein Surety, any one or more of the said Obligees may pay and discharge, or defend, any Municipal or Mechanics' Lien directed against any of the aforesaid mortgaged premises, when such lien takes precedence or is claimed to take precedence to or over any of the aforesaid First or Second Mortgages. However, within said fifteen days the said Surety may pay and discharge such liens, or may defend same to the satisfaction of said Trust Company or its Successors.

"(c) Should the said buildings and improvements be not fully completed in accordance with the aforesaid Plans and Specifications and Conditions within ten months from date hereof, any one or more of said Obligees may on fifteen days written notice to the herein Surety, arrange or contract for the completion of such unfinished work and/or material. However, said Surety may within the said fifteen days arrange for the completion of said unfinished work and material within sixty days from the date of such notice, by a party or parties satisfactory as to competence to said Trust Company or its Successors.

"In the event that any of the aforesaid buildings and improvements are not made and completed, free and clear of Municipal and Mechanics' Liens, as aforesaid, within the aforesaid ten months time for completion, and any holder of any of aforesaid three collateral notes shall thereafter cause the mortgage collateral or the equity in the mortgage collateral men-

tioned therein and still held to be offered at public sale, upon forty-five days written notice to said Obligors, mailed to the Philadelphia office or agency of the said Surety, of the place (in Philadelphia) and time, when such collateral will be publicly offered for sale, it is hereby agreed that any balance still remaining due and unpaid under the terms of such note, after applying the net proceeds arising from such sale, shall be, jointly and severally, due and payable by the said obligors unto the then holder of such note and assigns, as fully and effectively as if such holder and assigns were named Obligees in this Bond. The provisions of this paragraph shall be deemed an additional method for the establishment of any loss in the collection of the money or monies due under the terms of the said notes, respectively, due to incompletion, free and clear of liens, as aforesaid, and other rights, promises or obligations existing or arising under the terms of this Bond shall remain in force and effect, whether or not said method is employed." (R. 14, 15.)

The Trainor Company, however, failed to take advantage of any of the aforesaid remedies, but instituted suit against the Aetna Casualty and Surety Company on the aforesaid bonds and the case was tried without a jury in the United States District Court for the Eastern District of Pennsylvania before his Honor, Judge Kirkpatrick, who made the Findings of Fact hereinbefore set forth.

From the said Findings of Fact, the Judge concluded as a matter of law that, *inter alia,* the bond was a bond of guarantee and, therefore, since said bond was breached, the appellant was entitled to judgment and that the measure of damages was "so much of the difference between the value of the property as of August 13, 1928, with the houses uncompleted, and the value it would have had on that date had the houses been completed, as would have been neces-

sary to pay the plaintiff's mortgage debt as well as all prior liens," and that, since the value of the property as of August 13, 1928, was more than the sum of the Appellant's mortgage and prior liens, the Appellant was not entitled to any substantial damages. (R. 35-36.) Judge Kirkpatrick then fixed the damages for the Appellant at the nominal sum of $5.00. (R. 43.)

Judgment was thereafter entered in accordance with said Opinion (R. 47), and an appeal was taken to the Circuit Court of Appeals for the Third Circuit on the principal ground that the Learned Trial Judge erred in making the aforesaid conclusions of law and in granting leave to the Appellant to enter judgment in the nominal sum of $5.00. (R. 54-56.)

In the meantime, pending the argument of this appeal, the Supreme Court handed down Opinions in the cases of *Mechanics Trust Company v. Fidelity and Casualty Co.*, 304 Pa. 526; and *Purdy v. Massey*, 306 Pa. 288, which decisions involved the discussion of the measure of damages recoverable for the breach of a completion bond.

At argument of the instant case before the Circuit Court of Appeals, counsel for Appellant in his Brief as well as at oral argument contended that the two aforesaid decisions presented the correct measure of damages to be applied in the instant case and that, said decisions having been decided by the local State Supreme Court, the Federal Courts were bound to follow said decisions.

The Circuit Court of Appeals, however, in an Opinion handed down by Judge Buffington (R. 63) unanimously affirmed the decision of the Court below in which they approved the measure of damage adopted by the Trial Court and further stated (R. 66-67) that they did not regard the case of "Purdy v. Massey as creating a new local law of

Pennsylvania," but as being merely declaratory of "the common law of that State . . . with respect not to property but to the subject of suretyship", concerning which matters the Federal Courts may, as they then did, exercise independent judgment. The Appellant thereupon petitioned your Honorable Court for a writ of certiorari, which writ of certiorari was granted on April 24, 1933.

THE QUESTIONS OF LAW INVOLVED.

1. Is there any substantial difference between the measure of damages recoverable by a mortgagee-obligee for the breach of a bond giving an absolute guarantee of completion and for the breach of a bond indemnifying against loss for failure to complete?

(*Answered by the Courts below in the negative.*)

2. Is the measure of damages due to a mortgagee-obligee for the breach of a bond guaranteeing completion of a building operation limited to the difference between the value of the property in the condition in which it existed at default and the amount of principal and interest due on the mortgage and all prior liens?

(*Answered by the Courts below in the affirmative.*)

3. Is the measure of damages to be applied in the instant case a matter of general law concerning which the Federal Courts may exercise their independent judgment?

(*Answered by the Circuit Court of Appeals in the affirmative.*)

ARGUMENT.

I. There Is No Substantial Difference Between the Measure of Damages Recoverable by a Mortgagee-Obligee for the Breach of a Bond Giving an Absolute Guarantee of Completion and for the Breach of a Bond Indemnifying Against Loss for Failure to Complete.

It is true that indemnity and guaranty completion bonds in favor of a mortgagee-obligee differ in this respect: namely, in the former, the compensation is measured by an anticipated loss; while in the latter by an actual loss. Or, in other words, in the former, the right of action does not accrue until the plaintiff has sustained a monetary loss; while in the latter, the right of action accrues immediately upon the breach. However, once the right of action has accrued, the mortgagee-obligee, irrespective of the type of the bond, is entitled to recover the same amount of damages as compensation for the loss which it has sustained. *Purdy v. Massey,* 306 Pa. 288, 297, 159 Atl. 545, 548 (1932) (dissenting opinion).

The basis for a different measure of damages in the various cases where the contractor has failed to complete his building operation does not lie in the nature of the completion bond but rather in the status of the obligee with respect to the building operation.

Where the owner is the obligee, his bargain contemplates the payment by him of a certain amount of money for a completed building and the contractor agrees to put the building on the premises for the specified price. It is the performance of that contract which is guaranteed by the surety company. If the contractor defaults, the situa-

tion is analogous to any other case in which a plaintiff seeks to recover as damages "the benefit of his bargain" which is the difference between the contract price and the reasonable and market cost of completion. In contemplation of law the owner has suffered a legal damage when he has been deprived of the benefit of his bargain to have a building erected at a certain price and, if it will cost the owner more to have the building erected, he is entitled to recover that excess whether or not he ever actually constructs the building. *Union Indemnity Co. v. Vettor,* 40 Fed. (2d) 606 (C. C. A. 5th 1930).

Such a situation differs vastly in fact and in legal significance from the case in which the obligee under a completion bond is a mortgagee and not an owner. In such case the obligee-mortgagee is equally entitled as against the surety company to the benefit of his bargain; but the determination of exactly what constitutes the bargain involves a totally different problem as to the measure of damages. Where a surety company guarantees to a mortgagee a completed building, the mortgagee-obligee has no interest in the premises or the building to be erected, other than as security for the mortgage obligation. The bargain contemplates that the premises shall be enhanced by the erection of the proposed building. That is the only interest which the mortgagee has in the building.

If, therefore, the contractor defaults and the building is not fully erected, the legal interest of the mortgagee which is adversely affected and which the law will be compelled to protect, and as to which compensation may be claimed, *is the loss to the mortgagee of his security by reason of the contractor's default.* Thus the mortgagee-obligee is entitled to recover as damages the amount by

which the security has been depleted by the failure of the contractor to perform, or so much of the difference between the value of the completed and uncompleted operation as would be necessary, together with the value of the property in the condition in which it is left by the contractor, to pay the mortgage debt and the interest thereon. *Province Securities Corp. v. Maryland Casualty Company,* 269 Mass. 75, 168 N. E. 252 (1929).

While the general language in the case of *Purdy v. Massey, supra,* may lend support to the appellant's proposition, it is submitted (as is hereinafter more fully set forth) that the authorities cited therein do not sustain the broad and sweeping language used by the Court and that the case should be restricted to its own peculiar facts. With regard to the case of *Weightman v. Union Trust Co.,* 208 Pa. 449, 57 Atl. 879 (1904) (also cited by the appellant), it should be noted that the question then before the Court was whether the mortgagee-obligee had set forth a complete cause of action against the defendant. In no place in said opinion did the Court discuss the measure of damages under which the plaintiff might recover compensation.

The cases of *Wicker v. Hoppock,* 73 U. S. 94 (1867) and *Hay v. Cudaback,* 139 Fed. 369 (C. C. A. 3d, 1905), are not in point although cited by the appellant as authority of Your Honorable Court and of the Circuit Court of Appeals for the Third Circuit supporting the appellant's contention. In the former case the defendant had agreed to bid in certain goods of X at a judicial sale at an agreed price if the plaintiff would proceed against X, obtain judgment, and levy on the said goods. The plaintiff fulfilled his part of the agreement but the defendant failed to bid at the sale. The plaintiff therein was allowed to recover the amount which defendant had agreed to bid. In the latter

case the plaintiff, as assignee, recovered from the defendants the amount which the defendants had agreed to pay to the plaintiff's assignor in the event that land which the plaintiff's assignor held as trustee for the defendant was sold on foreclosure and a deficiency judgment was entered against the said assignor. The land in question was sold on foreclosure and deficiency judgment entered against the assignor.

Nor are *Belloni v. Freeborn,* 63 N. Y. 383 (1875) and *Kidd v. McCormick,* 83 N. Y. 391 (1881), authority for the appellant's contention. The former case involved the defendant surety's guarantee of the payment by its principal of rent for which the plaintiff and defendant's principal were both liable but had nothing to do with a building operation or completion bond. The latter case dealt with the amount which the plaintiff, as a purchase money mortgagee, could recover from a fund deposited as collateral security for the defendant's promise to build certain houses on the said premises. The plaintiff, having foreclosed on default of defendant, completed the operation and recovered from the fund of $3000 his expenditures, and the difference between the value of the houses at default and the value if the same had been completed.

On the other hand in the later case of *Schwartz & Co. v. Aimwell Co.,* 227 N. Y. 184, 124 N. E. 892 (1919), the same Court refused recovery to the plaintiff, which was suing for breach of a guarantee bond, because it had failed to allege that its assignor had or would sustain any loss, the Court nowhere in its opinion discussing the difference between indemnity and guarantee completion bonds or what effect this difference may have on the measure of damages.

The appellee, therefore, respectfully submits that the measure of damages to be applied in a suit for breach of a completion bond is not dependent on whether the bond is one of indemnity or of guarantee, but rather upon the status of the obligee with respect to the building operation to be completed.

II. The Measure of Damages Due to a Mortgagee-Obligee for the Breach of a Bond Guaranteeing Completion of a Building Operation Is Limited to the Difference Between the Value of the Property in the Condition in Which It Existed at Default and the Amount of Principal and Interest Due on the Mortgage and All Prior Liens.

The measure of damages as above set forth has been adopted in suits by mortgagee-obligees for breach of completion bonds not only by the local District Court (R. 31) and by the Circuit Court of Appeals for the Third Circuit (R. 63), but also by decisions of various State Supreme Courts.

In *Province Securities Corporation v. Maryland Casualty Company,* 269 Mass. 75, 168 N. E. 252 (1929), the defendant bonding company had given a bond to a mortgagee conditioned upon the erection of certain buildings. These buildings were partly erected when the mortgage was foreclosed. The mortgagee bid in the property at considerably less than the amount of its lien and then sued the bonding company. The Court held with regard to the measure of damages that since a mortgagee holds the property for security only, it could not recover more than the difference between the value of the property at the time of default and the amount due on its mortgage.

The court first stated the rule applicable to suits brought by the owner of the property, and, after reciting this rule, said (p. 257):

> "The rule as to damages in case of a breach of an agreement to erect a building where the agreement is with the mortgagee, and not with the owner, is the same except that, as the mortgagee holds the property for security only, he cannot recover more than the difference between the value of the property in the condition in which it is left and the amount due on his mortgage."

The decision of the Supreme Judicial Court of Massachusetts was based upon the earlier case of *Norway Plains Savings Bank v. Moors,* 134 Mass. 129 (1883), in which the plaintiff had taken a mortgage and loaned money to cover the cost of certain construction on the mortgaged property. The owner and the contractor gave an undertaking to complete the buildings. It was found that they contained certain defects which reduced their value, and suit was brought by the mortgagee. In regard to the damages which could be recovered, the Court, speaking through Judge Colburn, said (p. 135):

> "The measure of damages is the difference between the value of the houses as they were in fact built, and the value they would have had if built in conformity to the agreement, or so much of this difference as would have been necessary, with the value of the houses as built, to have paid the mortgage debt and interest then due; and the time for determining these values was the time when the defendant left the houses, as finished, or as soon thereafterwards as the plaintiff had notice of the defects and deficiencies, or might have had such notice, by the exercise of reasonable diligence."

The same measure of damages was applied by the Supreme Court of Minnesota in the case of *Longfellow v. McGregor,* 61 Minn. 494, 63 N. W. 1032 (1895), where the mortgagee-obligee sued the surety for breach of bond conditioned on the principal's building a house by a certain date.

In *German American Title & Trust Company v. Citizens' Trust & Surety Company,* 190 Pa. 247, 42 Atl. 682 (1899), the Supreme Court of Pennsylvania adopted a similar rule of damages in the case where the owner of ground rents instituted suit for the breach of a completion bond. The plaintiff was there limited in recovery to the actual loss in the value of the ground rents.

In a dissenting opinion in the case of *Purdy v. Massey,* 306 Pa. 288, 297, 159 Atl. 545, 548 (1932), Mr. Justice Kephart presents a well-reasoned dissertation on this very question, wherein he approves and adopts the principle of law set forth in the aforementioned decisions and also adopted in this proceeding by the local District Court and unanimously affirmed on appeal by the Circuit Court of Appeals.

In regard to the surety's undertaking, Justice Kephart (p. 299) said:

> "In this case, however, the obligee of the surety's undertaking is not the owner of the property, but a mortgagee, and a different rule is and should be applied, as the mortgagee's interest is different and his loss occasioned by a failure to complete is likewise different. The owner is entitled to have his building as contracted for, but the mortgagee has no such contract as will entitle him to enforce such liability. The mortgagee has no interest in the property as such, (it is only security for his debt); and the fact that a bond

is given guaranteeing completion of a certain building upon it, adds nothing to this status nor does it alter or increase the holder's rights under his mortgage with respect to that property, though it may add to his security. The mortgagee has an interest in the property only in so far as the property stands as security for his debt, beyond this, he has no further interest. All he is entitled to in any case is full and adequate security for the sum he has advanced, and it is difficult to see how he can become entitled to anything more than this by virtue of the surety's undertaking as noted in the completion bond under consideration. The Court below having taken as the measure of damages the cost of completion was, in my opinion, in error.

It may often be that an incompleted structure will be of sufficient security value to protect the mortgagee, or that the land itself may be sufficient for this purpose. It seems plain that in such a case it could not be laid down as a rule that the mortgagee, who is adequately protected, would, by virtue of his bond, be entitled to collect what it would cost to construct the building in its entirety no matter to what extent it might be incompleted.

The correct measure of damage is the loss on the security value of the mortgage caused by the failure to complete. Here appellee's measure of damage is the difference between the value of the land without the building or the building in any state of completion, and the value with the completed building thereon, less the first mortgage; recovery being, of course, limited to the loss thus established on appellee's mortgage. See German-American Title & Trust Co. v. Citizens' Trust & Surety Co., 190 Pa. 247, where the owner of ground rents (a party with an interest quite similar to that of a mortgagee) brought suit for breach of a completion bond. The lower court allowed him as damage, not the cost of the completion of the building, but rather the

loss in the value of his ground rents. In affirming that decision, Justice Fell said: 'The jury were limited to the actual loss in the value of the ground rents, not exceeding the amount of the insurance, and were instructed that that loss would be represented by the difference in the market value of the ground rents if the buildings had been completed as provided by the agreement, and their value with the buildings in the uncompleted state in which they were left. We know of no better rule than this in such a case, and of none more just to the defendant.' Wheeler v. Equitable Trust Co., 221 Pa. 276, supports this view. The contract in that case was held to be one of indemnity, but as explained above the rule for ascertainment of damages should be the same whether the contract is one of indemnity or guaranty.

This question has been admirably discussed and this conclusion reached by Judge Kirkpatrick in Trainor Co. v. Aetna Casualty & Surety Co., 49 F. (2d) 769. So too, in Province Securities Corp. v. Md. Casualty Co., 269 Mass. 75, 168 N. E. 252, the conclusion is, 'The measure of damages is to be based on the difference in the value of the property as security arising from failure to comply with the conditions of the bond.' See also Norway Plains Savings Bank v. Moors, 134 Mass. 129; and Longfellow v. McGregor, 61 Minn. 494, to the same effect.

In the light of the foregoing discussion and on the authority of the cases cited, I would reverse the lower court."

We respectfully submit that, inasmuch as the trial Judge has found as a fact that the value of the buildings in their uncompleted state was in excess of the sum of the amount of appellant's mortgage on each house and all prior liens, the measure of damage (R. 35) which was applied by the trial Judge and affirmed by the Circuit Court of Appeals is the correct rule of damage and should be upheld,

namely, "the measure of damages in this case is so much of the difference between the value of the property as of August 13, 1928, with the houses uncompleted with the value on that date had the houses been completed as would have been necessary to pay the plaintiff's mortgage debt as well as all prior liens, since the value of the property as of August 13, 1928, was more than the sum of the amount of the appellant's mortgage and all prior liens, the plaintiff is not entitled to any substantial damages."

The appellant, however, contends that the case of *Mechanics Trust Co. v. Fidelity & Casualty Co.*, 304 Pa. 526, 156 Atl. 146 (1931), and the majority opinion in the case of *Purdy v. Massey, supra,* present the measure of damages applicable to the present suit. The appellee, on the other hand, submits that the former case is distinguishable from the case at bar in that the plaintiff trust company foreclosed its mortgage, bought the premises at the sale through its straw man, thereafter actually completed the said operation as the owner might have done and later sold the same at a profit. Naturally, the Court in determining the damages due to the plaintiff therein treated it as an owner and allowed it to recover the full sum of moneys *expended* by it in completing the operation. In the case at bar, the petitioner has not spent one penny for the construction of the buildings and was rightly treated as a mortgagee-obligee as distinguished from an owner-obligee. As a matter of fact the $28,000.00 obligation of the Copley Homes, Inc., to The Trainor Company was all profit to the latter company, accruing to it without any capital investment on its part (R. 31), and on which obligation The Trainor Company has received $13,026.02 (R. 35).

The case of *Purdy v. Massey, supra* (decided but with a dissenting opinion) is not so distinguishable from the case at bar but, being contrary to the prevailing decisions in states other than Pennsylvania, should be restricted to its own peculiar facts for the reason that the three authorities cited on page 295 as reported in 306 Pa. do not sustain the conclusions with respect to the measure of damages for which they are cited. *Mechanics Trust Co. v. Fidelity & Casualty Co., supra,* has already been discussed and distinguished. The case of *Equitable Trust Co. v. National Surety Co.,* 214 Pa. 159, 63 Atl. 699 (1906) has been carefully considered and distinguished by Judge Kirkpatrick in his opinion (R. 38), while in the case of *Board of Education v. Maryland Casualty Company,* 27 Fed. (2d) 20 (C. C. A. 3d 1928) the plaintiff was the owner of the property, not the mortgagee, and, as owner, actually sustained damages in completing the operation.

The appellee further submits that the measure of damages applied in the case at bar by the Trial Judge and unanimously affirmed by the Circuit Court of Appeals is not opposed to the law as stated by Your Honorable Court. On the contrary, counsel for appellee has been unable to discover any decision of Your Honorable Court bearing on the question raised herein by the appellant. The case of *Wicker v. Hoppock,* 73 U. S. 94 (1867), in which is set forth the general distinction between an obligation to do a certain thing and an obligation to indemnify against loss, is not authority for appellant's contention. The facts hereinbefore set forth make its inapplicability self-evident.

The appellee further submits that there is no conflict of authority among the Circuit Courts of Appeals for the various Circuits and that there is no such conflict of author-

ity among the Supreme Courts of the various states with regard to the measure of damages applied in the present proceeding as to justify Your Honorable Court's further consideration of this matter.

III. The Trial Court and the Circuit Court of Appeals in Affirming the District Court Were Both Entitled to Exercise Their Independent Judgment Regarding the Proper Measure of Damages to be Awarded the Petitioner.

1. Federal Courts Exercise an Independent Judgment, Irrespective of the Decisions of the Local State Courts in Matters of General Jurisprudence and Commercial Law.

It is urged by the appellant that under Section 34 of the Judiciary Act of 1789 (now R. S. § 721, U. S. C. A. Title 28 § 725) the Federal Courts are bound by the decisions of the local state courts and must follow the decisions of their respective local state courts in awarding damages to a mortgagee-obligee in a suit for the breach of a completion bond. This contention necessitates a study of the aforesaid thirty-fourth section of the Judiciary Act of 1789 as interpreted and construed in the various decisions of your Honorable Court.

The leading case of *Swift v. Tyson*, 16 Pet. 1 (1842) stands for the proposition that the Federal Courts, regardless of state decisions, will exercise their independent judgment upon those questions dependent upon principles of general jurisprudence or relating to general or commercial law. In that case Mr. Justice Story states on page 18:

> "It is, however, contended, that the thirty-fourth section of the judiciary act of 1789, ch. 20, furnishes a

rule obligatory upon this Court to follow the decisions of the state tribunals in all cases to which they apply. That section provides 'that the laws of the several states, except where the constitution, treaties, or statutes of the United States shall otherwise require or provide, shall be regarded as rules of decision in trials at common law in the Courts of the United States, in cases where they apply.' In order to maintain the argument, it is essential, therefore, to hold, that the word 'laws,' in this section, includes within the scope of its meaning the decisions of the local tribunals. In the ordinary use of language it will hardly be contended that the decisions of Courts constitute laws. They are, at most, only evidence of what the laws are, and are not of themselves laws. They are often re-examined, reversed, and qualified by the Courts themselves, whenever they are found to be either defective, or ill-founded, or otherwise incorrect. The laws of a state are more usually understood to mean the rules and enactments promulgated by the legislative authority thereof, or long established local customs having the force of laws. In all the various cases, which have hitherto come before us for decision, this Court have uniformly supposed, that the true interpretation of the thirty-fourth section limited its application to state laws strictly local, that is to say, to the positive statutes of the state, and the construction thereof adopted by the local tribunals, and to rights and titles to things having a permanent locality, such as the rights and titles to real estate, and other matters immovable and intraterritorial in their nature and character. It never has been supposed by us, that the section did apply, or was designed to apply, to questions of a more general nature, not at all dependent upon local statutes or local usages of a fixed and permanent operation, as, for example, to the construction of ordinary contracts or other written instruments, and especially to questions of general commercial law, where the state

> tribunals are called upon to perform the like functions as ourselves, that is, to ascertain upon general reasoning and legal analogies, what is the true exposition of the contract or instrument, or what is the just rule furnished by the principles of commercial law to govern the case. And we have not now the slightest difficulty in holding, that this section, upon its true intendment and construction, is strictly limited to local statutes and local usages of the character before stated, and does not extend to contracts and other instruments of a commercial nature, the true interpretation and effect whereof are to be sought, not in the decisions of the local tribunals, but in the general principles and doctrines of commercial jurisprudence. Undoubtedly, the decisions of the local tribunals upon such subjects are entitled to, and will receive, the most deliberate attention and respect of this Court; but they cannot furnish positive rules, or conclusive authority, by which our own judgments are to be bound up and governed."

This doctrine has been affirmed and elaborated in the many subsequent decisions and become so well established that it hardly needs the approval evidenced by the following cases.

In *Butz v. City of Muscatine,* 8 Wall. 575, 582 (1869), the question was presented whether mandamus lay to compel the mayor of the city and its aldermen to levy a tax to pay a judgment in favor of the plaintiff. The court in exercising its own judgment in this matter said:

> "There are several adjudications of the highest court of the State more or less adverse to the views we have expressed. We do not deem it necessary more particularly to advert to them. Entertaining the highest respect for those by whom they were made, we

have yet been unable to concur in the conclusions which they announce. It is alike the duty of that court and of this to decide the questions involved in this class of cases, as in all others, when presented for decision. This duty carries with it investigation, reflection, and the exercise of judgment. It cannot be performed on our part, by blindly following in the footsteps of others and substituting their judgment for our own.

"Were we to accept such a solution we should abdicate the performance of a solemn duty, betray a sacred trust committed to our charge, and defeat the wise and provident policy of the Constitution which called this court into existence."

In *Baltimore and Ohio Railroad Company v. Baugh,* 149 U. S. 368, 371 (1892), the Court said:

"In all the various cases which have hitherto come before us for decision, this court has uniformly supposed that the true interpretation of the thirty-fourth section limited its application to state laws strictly local, that is to say, to the positive statutes of the State, and the construction thereof adopted by the local tribunals, and to rights and titles to things having a permanent locality, such as the rights and titles to real estate, and other matters immovable and intraterritorial in their nature and character."

Black and White Taxicab and Transfer Company v. Brown and Yellow Taxicab and Transfer Company, 276 U. S. 518 (1928), is a recent case in which the plaintiff sued to enjoin defendant from interfering with plaintiff's prior contract with a Kentucky railroad. The Kentucky courts had held that similar contracts were invalid, while federal courts had sustained such contracts. The court in discussing what law should be applied to the case said:

"The contract gives respondent, subject to termination on short notice, license or privilege to solicit patronage and park its vehicles on railroad property at train time. There is no question concerning title to land. No provision of state statute or constitution and no ancient or fixed local usage is involved. For the discovery of common law principles applicable, in any case, investigation is not limited to the decision of the courts of the State in which the controversy arises. State and federal courts go to the same sources for evidence of the existing applicable rule. The effect of both is to ascertain that rule. Kentucky has adopted the common law and her courts recognize that its principles are not local but are included in the body of the law constituting the general jurisprudence prevailing wherever the common law is recognized. *Hunt v. Warnicke's Heirs,* 3 Hardin 61. *Lathrop v. Commercial Bank,* 8 Dana 114, 121. *Ray v. Sweeney,* 14 Bush 1, 9, et seq. *Aetna Insurance Co. v. Commonwealth,* 106 Ky. 864, 876. *Nider v. Commonwealth,* 140 Ky. 684, 686. And see I Kent's Commentaries (14th ed.) pp. 451, 602. As respects the rule of decision to be followed by federal courts, distinction has always been made between statutes of a State and the decisions of its courts on questions of general law. The applicable rule sustained by many decisions of this Court is that in determining questions of general law, the federal courts, while inclining to follow the decisions of the courts of the State in which the controversy arises, are free to exercise their own independent judgment. That this case depends on such a question is clearly shown by many decisions of this Court."

Mr. Justice Holmes, in a dissent (in which Mr. Justice Brandeis and Mr. Justice Stone concurred) declared that the question before the Court was one of local law for the reason that the authority of the railroad to act had been

given by Kentucky law and the matter pertained to the use of land in Kentucky. Mr. Justice Holmes by way of dictum in the said case furthermore stated that, although he believed the word "laws" as used in the 34th Section of the Judiciary Act of 1789 to include court decisions as well as statutory law and that the said section should have been so construed, the doctrine of *Swift v. Tyson, supra,* had become so fixed in our jurisprudence that he would not reverse it, reserving, however, for further consideration the question of its applicability to problems arising in new fields of law.

However, although the foundations of the rule of *Swift v. Tyson, supra,* have thus been assailed in the dissenting opinion in the aforesaid case and also in the dissenting opinion in *Kuhn v. Fairmont,* 215 U. S. 349 (1909), the rule has nevertheless become so well settled as to necessitate legislative action if a change is to be made therein.

As early as in 1893 it was recognized that the construction placed on the 34th section of the Judiciary Act of 1789 by *Swift v. Tyson, supra,* and decisions subsequent thereto must have been that which Congress intended it to be, otherwise this section would have been amended by Congress, *Baltimore and Ohio Railroad v. Baugh, supra.* More than forty years have elapsed since Mr. Justice Brewer judicially made this observation and yet, in spite of the two aforesaid attacks on the soundness of this rule, Congress has taken no step to amend the section. We, therefore, respectfully submit that under the decisions of your Honorable Court the rule is now well settled that the federal courts are entitled to and duty bound to exercise their independent judgment in matters of general jurisprudence and of commercial law.

That the doctrine of *Swift v. Tyson, supra,* is recognized and applied by *all* of the Circuit Courts of Appeals will be evident by reference to the following decisions:

Sears v. Greater New York Development Co., 51 F. (2d) 46 (C. C. A. 1st 1931);

Cole v. Pennsylvania Railroad Co., 43 F. (2d) 953 (C. C. A. 2d 1930);

Trainor Co. v. Aetna Casualty & Surety Co., 62 F. (2d) 487 (C. C. A. 3d 1932);

Long v. Monarch Accident Ins. Co., 30 F. (2d) 929 (C. C. A. 4th 1929);

Home Ins. Co. v. Currie, 54 F. (2d) 203 (C. C. A. 5th 1931);

Farmers' Bank v. Hayes, 58 F. (2d) 34 (C. C. A. 6th 1932);

Aetna Life Ins. Co. v. Roewe, 38 F. (2d) 393 (C. C. A. 7th 1930);

Odegard v. General Casualty & Surety Co., 44 F. (2d) 31 (C. C. A. 8th 1930);

Community Bldg. Co. v. Maryland Casualty Co., 8 F. (2d) 678 (C. C. A. 9th 1925);

Bu-Vi-Bar Petroleum Corporation v. Krow, 40 F. (2d) 488 (C. C. A. 10th 1930).

Thus there is virtually no question that it is now the settled principle of law supported by copious authority and long tradition that independent action on the part of the federal courts "is precluded only in cases where the state has spoken in its statutes or its courts have laid down some rule of real property or established some settled pol-

icy in regard to local matter." *Cole v. Pennsylvania, supra,* at 957.

As a matter of fact, not only has the said rule been well established in our jurisprudence, but, as so very fittingly and succinctly stated by Mr. Justice Brewer in *Baltimore and Ohio Railroad, supra,* "whatever differences of opinion may have been expressed, have not been on the question whether a matter of general law should be settled by the independent judgment of this court rather than through an adherence to the decisions of the state courts, but upon the other question, whether a given matter is one of local or general law."

2. The Question of Measure of Damages for Breach of a Completion Bond Whether Considered to Be a Matter of Suretyship or of Damages Is Primarily a Matter of General Jurisprudence Concerning Which the Federal Courts May Exercise Their Independent Judgment.

(a) *Questions of suretyship are matters of general jurisprudence.*

In *Odegard v. General Casualty & Surety Co.,* 44 F. (2d) 31 (C. C. A. 8th 1930) suit was instituted on a surety bond given to secure the performance of a contract for the sale of lumber and lumber products. The question there presented was whether state or federal law should be applied in determining the effect of the failure of the obligee to notify the surety of principal's default. The Court held this to be a matter of suretyship governed by general jurisprudence and, therefore, applied federal law.

In *Kansas City Hydraulic Press Brick Co. v. National Surety Co.,* 149 Fed. 507 (C. C. Mo. 1906) and 167 Fed. 496

(C. C. A. 8th 1909) the trial and appellate courts both held that, although the state law governed the question as to whether or not a contract between the city and the contractor was valid when entered into without competitive bidding, the question as to the validity of the surety bond given for the materialmen was a matter of general jurisprudence to be decided independently by the federal court.

The decisions with regard to types of insurance other than surety bonds seem to be more numerous.

As early as 1842 in the case of *Carpenter v. The Providence Washington Ins. Co.*, 16 Pet. 495 (1842) the construction of a fire insurance policy was held a matter of general jurisprudence, although such a contract is by its nature closely connected with real estate. Similarly, *Meigs v. London Assurance Co.*, 126 Fed. 781 (C. C. Pa. 1904), affirmed 134 Fed. 1021 (C. C. A. 3d 1905) is a suit on a fire insurance policy in which the Court when confronted with the problem as to whether a case of double insurance was made out so as to require contribution applied the federal rule as distinguished from the Pennsylvania rule and denied recovery to the plaintiff of that amount which he would have been allowed under the decisions of the Supreme Court of Pennsylvania. In this connection the Court said (p. 784):

> "This is the law of the Federal Courts and while I regret to differ from the view of this controversy taken by the Supreme Court of Pennsylvania, I am bound by the decisions of the appellate tribunals of the United States. *The question is one of general commercial law, upon which the federal courts are at liberty to entertain an independent opinion.*" (Italics ours.)

In *Washburn & Moen Mfg. Co. v. Reliance Co.*, 179 U. S. 1 (1900), the Court held that questions relating to marine insurance were matters of general jurisprudence concerning which Federal Courts could exercise their independent judgment.

Accident and health insurance policies are likewise subjects concerning which Federal Courts exercise their independent judgment. In *Long v. Monarch Accident Ins. Co.*, 30 F. (2d) 929 (C. C. A. 4th, 1929), the Court applied the federal rule in deciding the question whether such a policy had been forfeited when the insurance company failed to apply to the payment of premium the funds which it held due to the assured.

Numerous decisions have been rendered bearing on the federal court's right to construe the various provisions of life insurance policies, irrespective of decisions by state courts on the same subject.

In *Security Life Ins. Co. v. Brimmer,* 36 F. (2d) 176 (C. C. A. 8th, 1929), (Certiorari denied 281 U. S. 744 (1930)), the effect of false representations which were not within the ban of a state statute was held to be a matter of general law.

Similarly in *Aetna Life Ins. Co. v. Roewe,* 38 F. (2d) 393 (C. C. A. 7th, 1930), the federal court refused to follow the state decisions regarding the power of an agent of the insurance company to waive a condition in the policy with regard to the payment of the first premium.

Spinks v. Mutual Reserve Fund Life Ass'n, 137 Fed. 167 (C. C. E. D. Ky., 1905), is a case where the federal court held that the question of validity of a provision in life insurance policy that no suit could be instituted on the same after a lapse of one year following the death of the assured is one of general jurisprudence.

See also *Kibby v. New England Mutual Life Ins. Co.*, 59 F. (2d) 9 (C. C. A. 3d, 1931).

Questions involving the law of guaranty are likewise considered matters of general jurisprudence as distinguished from local law. *Johnson v. Charles D. Norton Co.*, 159 Fed. 361 (C. C. A. 6th, 1908), is a case where in a suit on letters of guaranty the court refused to apply Pennsylvania law, saying on page 363:

> "A contract of guaranty is a well known form of commercial contract as to the construction and effect of which the federal courts are not bound to follow state decisions not based on local statute or usages having the force of local law."

Matters relating to negotiable bonds and especially to the question whether coupons on such bonds bear interest after maturity are governed by the principles of general jurisprudence. *Sears v. Greater New York Development Co.*, 51 F. (2d) 46 (C. C. A. 1st, 1931).

In *Farmers' Bank v. Hayes*, 58 F. (2d) 34 (C. C. A. 6th, 1932), the Court held that the question of the right of a bank as assignee of a contractor to the retained percentage fund as against the surety completing the building operation after default was a matter of general law concerning which the federal court should exercise its independent judgment.

Also in *Bancroft v. Hambly*, 94 Fed. 975 (C. C. A. 9th, 1899), the Court held that the construction of an employment contract was a matter of general jurisprudence.

In this proceeding the subject matter under review is a completion bond which the respondent had executed as surety. Suit was instituted against the appellee as surety

for damages resulting from the breach of said bond. The trial judge found as a matter of fact that the bond had been breached and that the surety was liable thereunder. These questions of fact are not subject to review in this proceeding. The trial judge, however, after making the aforesaid findings of fact and conclusions of law, was confronted with the further problem as to the amount of damages to which the petitioner, as obligee, was entitled under the terms of the said bond to recover from the respondent, as surety. The trial judge, after a thorough and comprehensive review of all the pertinent decisions of the various state and federal courts and especially the decisions of the Supreme Court of Pennsylvania, concluded that the measure of damages due to a mortgagee-obligee for the breach of a bond guaranteeing completion of a building operation was limited to the difference between the value of the property in the condition it existed at default and the amount of principal and interest due on that mortgage and all prior liens.

Thereafter the Supreme Court of Pennsylvania handed down its decision in the case of *Purdy v. Massey,* 306 Pa. 288 (1932), in which the Court on facts, manifestly different from that arising out of the usual building operation, adopted as the measure of damages a rule contrary to that enunciated and adopted by the trial judge in the instant case.

On appeal to the Circuit Court of Appeals for the Third Circuit, the said appellate court in affirming the decision of the court below said:

> "We do not regard the decision in Purdy v. Massey as creating a new local law of Pennsylvania but that, at most, it declared the common law of that state (as those terms are used in the two decisions last cited) with

> respect not to property but to the subject of suretyship, which from its very nature is general law running, like commercial law, broadly through all the states. In such case 'where the common law of the state is derived from the principles of general jurisprudence common to all the states' a federal court may (as we have done) exercise an independent judgment as to what is the law without respect to the decision of the state court as binding authority." (R. 66) (*Trainor Co. v. Aetna Casualty & Surety Co.*, 62 F. (2d) 487, 489 (C. C. A. 3d 1932)).

We, therefore, submit that under the authority of the aforesaid decisions the amount of damages to which the appellant is entitled to recover from the appellee for the breach of said bond, executed by the appellee as surety, was and still is a matter of suretyship dependent upon the terms of said bonds and the Court's interpretation and construction of the same, and, therefore, was and still is a matter of general jurisprudence concerning which the trial judge and the Circuit Court of Appeals for the Third Circuit rightly exercised their independent judgment.

(b) *The questions relating to the measure of damages are matters of general jurisprudence.*

In *Lake Shore & Michigan Southern Railway Co. v. Prentice,* 147 U. S. 101 (1893), the Court was confronted with the question whether the plaintiff could recover punitive damages against the defendant railroad company for the wanton arrest of the plaintiff by the defendant's conductor while the plaintiff was a passenger on defendant's train or whether the plaintiff was limited to compensatory damages. There was a split of opinion on this question among the supreme courts of the various states but the

Court held that this question was a matter of general jurisprudence and, therefore, exercising its own independent judgment, disallowed exemplary damages.

The Court in *Norfolk & P. Traction Co. v. Miller,* 174 Fed. 607 (C. C. A. 4th 1909), also reached the same conclusion on similar facts.

Clark v. Belt, 223 Fed. 573 (C. C. A. 8th 1915), is a case where plaintiff sued for restitution for the defendant's failure to convey land which he had agreed to convey to the plaintiff. The Court held that it was not necessary to determine what the state rule as to damages was because such a question was one of general jurisprudence concerning which federal courts exercise independent judgment. It should be noted that the question before the Court in *Clark v. Belt, supra,* seemingly concerns itself much more with a possible local policy or rule of law than the breach of a completion bond.

In *Bu-Vi-Bar Petroleum Corporation v. Krow,* 40 F. (2d) 488 (C. C. A. 10th 1930), suit was instituted to recover damages for the breach of a contract to drain an oil and gas well. The Court held that the measure of damages for the breach of said contract was a question of general jurisprudence. Likewise the question in this case seemingly concerns itself more with a possible local policy or rule of law than the breach of a completion bond, yet the Court again asserted the matter to be one of general jurisprudence.

Similarly in *Woldson v. Larson,* 164 Fed. 548 (C. C. A. 9th 1908) in a suit involving alienation of affection the Court held that the measure of damages was a matter of

general jurisprudence and allowed the recovery of exemplary damages, although the local state court limited recovery in such suits to compensatory damages. Nor did the Court feel that there was such a question of local public policy involved therein as to require it to follow the local state decisions.

See also *Mitsubishi Shoji Kaisha, Ltd., v. Davis,* 291 Fed. 882 (D. C. N. Y. 1922), where, in suit for damages for non-delivery of goods by carrier, the amount of damages recoverable was a matter of general jurisprudence.

Thus we submit that, if the question at issue in the instant case be considered a matter of Damages as distinguished from a matter of Suretyship (hereinbefore discussed under division III 1. (a)), it was and still is one of general jurisprudence concerning which the trial judge and the Circuit Court of Appeals rightly exercised their independent judgment.

(c) *The use of completion bonds throughout the Nation requires a national uniform law and, therefore, questions pertaining thereto are matters of general jurisprudence.*

Furthermore, irrespective of the question as to whether the amount of damages recoverable by the petitioner be considered a matter of Suretyship or of Damages, we submit that this matter is of sufficient commercial importance so as to warrant the federal courts exercising their independent judgment and establishing a rule of law which will be uniform and applicable in every state of the Union. The surety business is nation wide; it is not restricted to any particular state or group of states. While comparatively few of such bonds are now being written,

when building operations again get under way, such bonds will once more constitute an important part of the surety business. It will then be even more self-evident than now that a uniform law throughout the country with regard to the measure of damages applicable in a suit for the breach of such bonds is as indispensable for the successful promotion of the surety business as the uniformity which is now afforded transactions involving commercial paper and other types of insurance is for those businesses.

We, therefore, submit that for this reason as well as other reasons elsewhere discussed in this brief, the question now before your Honorable Court involves a matter concerning which the federal courts are rightly entitled to exercise their independent judgment.

3. Irrespective of Whether or Not the Question of Measure of Damages in the Instant Case be Considered a Matter of General Jurisprudence the Federal Courts Below Were Entitled to Exercise an Independent Judgment Concerning the Question.

The appellant contends that the Circuit Court of Appeals erred in failing to hold that the law of the instant case is governed by the decisions of the Supreme Court of Pennsylvania in the cases of *Mechanics Trust Co. v. Fidelity & Casualty Co., supra,* and *Purdy v. Massey, supra,* which decisions were handed down on June 27, 1931, and February 3, 1932, respectively. A glance at the docket entries (R. 1) will reveal that these decisions were rendered by the local state court subsequent to the date (February 13, 1931) when the opinion of the trial judge was filed in the instant case wherein leave was granted for the appellant to enter judgment in the amount of $5.00, but

prior to the date (December 21, 1932) when the opinion of the Circuit Court of Appeals was filed.

Granting for purposes of argument that both of the aforesaid recent decisions of the Supreme Court of Pennsylvania are contrary to the rule of law adopted by the trial judge in the instant case and affirmed by the Circuit Court of Appeals, we nevertheless submit that the federal courts in the present proceeding were and still are entitled and under a definite duty to exercise their independent judgment, irrespective of whether or not the question at issue be held to be a matter of jurisprudence. Neither at the time when the trial judge filed his opinion in the instant case nor at the time judgment was ultimately entered had the Supreme Court of Pennsylvania adopted any definite rule on this question. The problem was practically *de novo* in Pennsylvania except insofar as the decisions of the Supreme Court of Pennsylvania on analogous or related situations would indicate what rule would probably be adopted by the state court when confronted with the problem. With the decisions of the local state supreme court in such a state it was the duty of the federal trial judge to exercise his independent judgment, giving due consideration, of course, to the decisions of the Supreme Court of Pennsylvania bearing on analogous and related situations. This the learned trial judge did in a thorough and comprehensive opinion in which he adopted as the measure of damages that rule of law which he considered not only proper and sound but also in line with the then existing decisions of the Supreme Court of Pennsylvania. That the said trial judge acted correctly and that the Circuit Court of Appeals on appeal in this proceeding was likewise entitled to exercise its independent judgment, in spite of the fact that the Supreme Court of Pennsylvania

had in the meantime adopted a contrary rule, is evidenced by the following cases:

In *Burgess v. Seligman,* 107 U. S. 20 (1882), suit was instituted against the shareholders on a judgment obtained against the dissolved corporation of which defendants were shareholders by virtue of a state statute. The defendants, who held the stock in escrow, claimed that they were not liable. After the Circuit Court of Appeals decided that there was no liability, the state supreme court in similar cases decided there was such liability. On appeal, the Court exercised its independent judgment and affirmed the judgment of the Circuit Court of Appeals, saying on page 33:

> "We do not consider ourselves bound to follow the decision of the state court in this case. When the transactions in controversy occurred, and when the case was under the consideration of the Circuit Court, no construction of the statute had been given by the State Tribunals contrary to that given by the Circuit Court. . . . where the law has not been thus settled, it is the right and duty of the Federal courts to exercise their own judgment; as they also always do in reference to the doctrines of commercial law and general jurisprudence. So when contracts and transactions have been entered into, and rights have accrued thereon under a particular state of the decisions, or when there has been no decision, of the State tribunals, the Federal courts properly claim the right to adopt their own interpretation of the law applicable to the case, although a different interpretation may be adopted by the State courts after such rights have accrued."

In *Kuhn v. Fairmont Coal Co.,* 215 U. S. 349 (1910), the following question was certified by the Circuit Court of Appeals:

"Is this court bound by the decision of the Supreme Court in the case of *Griffin v. Fairmont Coal Company,* that being an action by the plaintiff against the defendant for damages for a tort, and this being an action for damages for a tort based on facts and circumstances almost identical, the language of the deeds with reference to the granting clause being in fact identical, that case having been decided *after* the contract upon which defendant relies was executed, *after* the injury complained of was sustained, and *after* this action was instituted?"

The question was answered by your Honorable Court in the negative. On page 360 of the opinion Mr. Justice Harlan said:

"We take it, then, that it is no longer to be questioned that the Federal Courts in determining cases before them are to be guided by the following rules . . . . 3. *But where the law of the State has not been thus settled,* it is not only the right but the duty of the Federal court to exercise its own judgment, as it also always does when the case before it depends upon the doctrines of commercial law and general jurisprudence. 4. So, when contracts and transactions are entered into and rights have accrued under a particular state of the local decisions, *or when there has been no decision by the state court on the particular question involved,* then the Federal courts properly claim the right to give effect to their own judgment as to what is the law of the state applicable to the case, even where a different view has been expressed by the state court after the rights of parties accrued."

Concordia Insurance Company of Milwaukee v. School District No. 98 of Payne County, Oklahoma, 282 U. S. 545 (1931), is a recent case in which your Honorable Court

affirmed the right of the federal district court to exercise its independent judgment on the question as to whether under state statute, interest could be recovered on a fire policy from date of liability, the decisions of the state court being at that time in such confusion that the meaning of the statute could not definitely be determined. Furthermore, the Court held it was not bound by a subsequent decision handed down a year after the judgment in the case had been entered by the federal district court.

In *Henry W. Putnam Memorial Hospital v. Allen*, 34 F. (2d) 927 (C. C. A. 2d 1929), the Court held that where there was no decision whatsoever on the question the federal courts were under a duty to exercise their independent judgment, while the case of *John Deere Plow Co. v. Mowry*, 222 Fed. 1 (C. C. A. 6th 1915), stands for the proposition that when there is no settled rule in the state court applicable to the *precise facts*, the federal court will exercise their own judgment. In the latter case the controversy involved the question whether a contract was set forth a conditional sale or a sale secured by a chattel mortgage.

In *Hart v. Adair*, 244 Fed. 897 (C. C. A. 9th 1917), the Court refused to be bound by a recent case of the Oregon Supreme Court, saying on page 901:

> "That decision is not binding upon this court. It does not construe or apply any state statute. Nor does it create a rule of property. And, even if it did, it would not be controlling authority here; for it was not rendered until a year after the court below decided the case which is now before us, and not until long after the rights of the plaintiffs had accrued under the assignment. A federal court is not bound by the decision of the highest court of the state in such a case. Burgess

v. Seligman, 107 U. S. 20, 2 Sup. Ct. 10, 27 L. Ed. 359; Carroll County v. Smith, 111 U. S. 556, 562, 4 Sup. Ct. 539, 28 L. Ed. 517; Julian v. Central Trust Co., 193 U. S. 93, 103, 24 Sup. Ct. 399, 48 L. Ed. 629; Great Southern Hotel Co. v. Jones, 193 U. S. 532, 24 Sup. Ct. 576, 48 L. Ed. 778; Jones v. Great Southern Fireproof Hotel Co., 86 Fed. 370, 30 C. C. A. 108; City of Mankato v. Barber Asphalt Paving Co., 142 Fed. 329, 73 C. C. A. 439."

See also *Dernberger v. Baltimore & Ohio Railway Company,* 243 Fed. 21, 40 (C. C. A. 4th 1917).

We, therefore, submit that irrespective of whether or not the question of measure of damages in the instant case be considered a matter of general jurisprudence, the Federal Courts below were entitled to exercise an independent judgment concerning the question.

Conclusion.

It is submitted that there is no substantial difference as to the measure of damages recoverable by a mortgagee-obligee for the breach of a bond guaranteeing completion of a building operation and for the breach of a bond indemnifying said obligee against loss for failure to complete. In the event that the mortgagee sues for breach of either type of bond, the measure of damages recoverable by said mortgagee-obligee is limited to the difference between the value of the property in the condition in which it was at the time of default and the amount of principal and interest due on the mortgage and all prior liens. And furthermore, since the measure of damages is a matter of general law, the Federal Court may exercise its independent judgment and apply the aforesaid measure of damages, irrespective of any decision of the local state Supreme Court which is in apparent conflict therewith.

It is, therefore, respectfully submitted that the judgment of the Circuit Court of Appeals should be affirmed.

Respectfully submitted,

JOSEPH W. HENDERSON,
THOMAS F. MOUNT,
Counsel for Appellee.

CORRECTED COPY

SUPREME COURT OF THE UNITED STATES.

No. 13.—October Term, 1933.

The Trainor Company, Petitioner, *vs.* The Aetna Casualty & Surety Company.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[November 6, 1933.]

Mr. Justice Sutherland delivered the opinion of the Court.

On October 13, 1927, petitioner conveyed to a building company a tract of real estate consisting of fifty-two lots, with the result that the building company became indebted to petitioner in the sum of $28,000, being part of the purchase price. The building company, in order to finance its operations, borrowed sums of money from two different corporations, to one of which it gave a first mortgage upon the real estate, and to the other a second mortgage. The building company then gave to petitioner its note for $28,000, and assigned as collateral security therefor its equity in the second mortgage. Petitioner accepted this security—in effect a third mortgage—upon the representation and warranty of the building company that a building and certain improvements would be erected, in accordance with plans and specifications, upon each of the fifty-two lots. The performance of this obligation was guaranteed by a bond in the sum of $220,000, executed by respondent, conditioned, among other things, to become void if within ten months from the date thereof, October 13, 1927, each of the fifty-two lots should be fully improved with a building, together with certain other improvements, in keeping with, and as shown by, the plans, specifications, etc.; otherwise to remain in full force and effect. The property is located in Pennsylvania, and the contract and the obligations of the bond were to be performed within that state.

Suit was brought in a federal district court for the eastern district of Pennsylvania to recover damages for a breach of the bond. A jury was waived; and after a hearing, the trial judge found

that on August 13, 1928, the date fixed for the completion of the buildings and improvements, twenty-four of the houses had been completed and twenty-eight had not been fully completed. The value of the lots with the twenty-eight uncompleted houses, as of the date last mentioned, was $6,700 each, an amount slightly in excess of the sum of petitioner's mortgage on each and of all prior liens. Completed, they would, on that date, have been worth $7,950 each. It is not disputed that at the time of the breach of the bond petitioner, under the terms of the mortgages, was powerless to protect itself by foreclosure; and the court found that thereafter the value of real estate, generally and in the locality, had steadily declined. On January 25, 1930, the first mortgage was foreclosed and the property bought in for the sum of $50, thus wiping out the second mortgage and the equity of petitioner therein. Petitioner has received on account of the indebtedness of $28,000 the sum of $13,026.02 only, leaving $14,973.98 still owing on the principal.

Upon these facts the trial court held that while the *owner* of property, in case of a default after partial performance of a building contract, would be entitled to recover from the surety the difference between the value of the property with the uncompleted buildings and its value with the buildings completed, the rule is otherwise in the case of a *mortgagee-obligee*. Following this view, that court concluded that the measure of damages in the instant case "is so much of the difference between the value of the property as of August 13, 1928, with the houses uncompleted, and the value it would have had on that date had the houses been completed as would have been necessary to pay the plaintiff's mortgage debt as well as all prior liens. Since the value of the property as of August 13, 1928, was more than the sum of the plaintiff's mortgage and prior liens, the plaintiff is not entitled to any substantial damages." The court, therefore, awarded nominal damages only. 49 F. (2d) 769. This judgment the circuit court of appeals affirmed. 62 F. (2d) 487. With that conclusion we are unable to agree.

It is very clear that the settled rule in Pennsylvania is to the contrary. In *Purdy* v. *Massey*, 306 Pa. 288, where prior cases are reviewed, the court held that where there is an absolute undertaking to erect and complete a building, the surety in case of default is bound to take the place of the principal and erect the

building, and the cost of doing that which should have been done is the measure of damages for which the surety is liable, not exceeding the amount of the bond. There the owner of a first purchase money mortgage had subordinated her security to another mortgage in consideration of the giving of a bond in all substantial respects like the one here under consideration. The building provided for was not erected, and the mortgagee brought suit against the surety on the bond. The court held that the bond was one of guaranty and awarded as damages the full cost of completion, such cost not exceeding the amount due on the mortgage. The applicable rule is thus stated (p. 295):

"In fixing compensation for damage resulting from breach of a contract the general rule is that the injured party should be placed in the same position as if there had been no breach. The object of the law is to place such party in as good position as if the contract had been kept. In the instant case the bond guaranteed the completion of the building; if there had not been a breach of the obligation of the bond, the building would have been erected. Since this was not done, the plaintiff can only be put in as good position as if the contract had been carried out by giving her the cost of construction, not exceeding, of course, the amount of the bond. The measure of damage on a bond guaranteeing completion is the cost of completion; . . . And in a case such as this, where the work was never begun, this cost will be the whole cost of construction."

See also *Mechanics Trust Co.* v. *Fid. & Cas. Co.*, 304 Pa. 526, 533, *et seq.* A like rule obtains in other states. *Real Estate Co.* v. *McDonald*, 140 Mo. 605, 612; *Kidd* v. *McCormick*, 83 N. Y. 391. Compare *Wicker* v. *Hoppock*, 6 Wall. 94, 99.

The circuit court of appeals held that the Pennsylvania decisions merely declared the common law of that state with regard to suretyship, and, since that law is derived from the principles of general jurisprudence common to all the states, a federal court in determining what it is might exercise an independent judgment. We do not deem it necessary to discuss the principle enunciated or to decide whether the Pennsylvania decisions come within it. It is enough to say that even where the principle applies, "for the sake of harmony and to avoid confusion, the Federal courts will lean towards an agreement of views with the State courts if the question seems to them balanced with doubt." *Burgess* v. *Seligman*, 107 U. S. 20, 33-34. And see *Sim* v. *Edenborn*, 242 U. S. 131, 135,

where the authorities are collected; *Community Bldg. Co.* v. *Maryland Casualty Co.*, 8 F. (2d) 678, 680. In the present case it would not be going far enough to say merely that the question is "balanced with doubt," for it seems to us that the Pennsylvania decisions, and those of the other states cited above, are plainly right. Compare *Messenger* v. *Anderson*, 225 U. S. 436, 444.

The petitioner here, not being willing to accept a third mortgage on the unimproved land to secure its debt, required the added security which would be afforded by completed improvements. These improvements the building company agreed to make within a definitely fixed time, and for the performance of that undertaking respondent, for a valuable consideration, stood sponsor. Plainly the obligation of the bond was one of guaranty and not indemnity, and could be fulfilled only by the erection of the buildings or payment of the penalty in case of default. It is no answer to say that the value of the property immediately after the default exceeded the sum of the mortgage together with all prior liens. Petitioner was then without remedy against the property because its mortgage was not in default. It was, therefore, obliged to sit by and await the action of others over which it had no control. In the meantime, the uncompleted buildings necessarily lay unroofed, subject to expense in the way of taxes, insurance, accumulating interest, etc., deteriorating in quality and steadily declining in value. Petitioner is entitled to be put in as good position in respect of its debt as it would have occupied if the buildings had been completed in accordance with the terms of the undertaking; and this can be done here only by giving it the amount of the difference between the value of the unfinished buildings and their value as it would have been if completed in accordance with the agreement—see *Kidd* v. *McCormick, supra,* p. 398—but exceeding neither the amount due on its debt nor the amount of the bond.

It appears from the findings that this difference would be about $26,000, while the amount now due petitioner is $14,973.98, together with interest thereon from August 13, 1928. It follows that the judgments of the courts below must be reversed and the cause remanded to the district court with directions to enter judgment for the last named sum.

So ordered.